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LAW OFFICE

**MCLEOD, WATKINSON & MILLER**

MICHAEL R. MCLEOD  
WAYNE R. WATKINSON  
MARC E. MILLER  
RICHARD T. ROSSIER  
DEVARIESTE CURRY  
RICHARD PASCO  
ALEX MENENDEZ  
AMY B. JONES  
CHRISTOPHER J. SALISBURY  
LIS KIDDER  
NATHANIEL GORDON-CLARK

ONE MASSACHUSETTS AVENUE, N.W.  
SUITE 800  
WASHINGTON, DC 20001-1401  
(202) 842-2345  
TELECOPY (202) 408-7763

Writer's e-mail address: evonsalzen@mwmlaw.com

ROBERT RANDALL GREEN  
LAURA L. PHELPS  
DAVID R. GRAVES  
WILLIAM E. O'CONNOR, JR.  
GOVERNMENT RELATIONS

ERIC VON SALZEN  
OF COUNSEL

January 10, 2012

Surface Transportation Board  
395 E Street, SW  
Washington, DC 20423-0001

ENTERED  
Office of Proceedings

JAN 10 2012

RE: Docket No. EP 712 – Improving Regulation and Regulatory Review  
Part of Public Board

Dear Chairman Elliott, Vice Chairman Mulvey, and Commissioner Begeman:

**Arkansas Electric Cooperative Corporation (AECC)** <sup>1/</sup> provides these comments in response to the Board's decision in this Docket served October 12, 2011 (clarified in the decision served December 21, 2011). AECC commends the Board for providing this opportunity for review and potential improvement of the Board's past regulatory practices, and believes that the insights to be gained are meaningful.

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<sup>1/</sup> AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 490,000 customers, or members, located in each of the 75 counties in Arkansas. In order to serve its 17 member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. For example, AECC holds ownership interests in the White Bluff plant at Redfield, Ark. and the Independence plant at Newark, Ark., each of which typically uses in excess of 6 million tons of Powder River Basin (PRB) coal each year. In addition, AECC holds an ownership interest in the Flint Creek plant, at Gentry, Ark., which normally uses in excess of 2 million tons of PRB coal each year. Because of the large volume of coal consumed by these plants, the need for long-distance rail transportation to move this coal, and the absence of rail competition at two of the plants, AECC has a direct interest in many aspects of the Board's regulation of the freight railroads.

Docket No. EP 712

January 10, 2012

Page 2

This regulatory review parallels and affirms the importance of the Board's authority under 49 USC 722(c) "at any time on its own initiative" to alter and adapt its past actions and practices in response to "substantially changed circumstances" as well as "new evidence". The practices of the Board and the ICC since the reforms introduced by the Staggers Act have occurred during – and, indeed, contributed to – profound changes of circumstance in the rail industry, including increased volumes, extensive network rationalization, and enhanced financial performance. Substantial new evidence has also become available, originating from the Board (e.g., the Christensen Study), as well as from shippers, railroads, and others. Under these circumstances, review of the Board's regulatory practices is not only appropriate, but also was fully contemplated by Congress in the authority it provided to the Board.

The Executive Orders and the Board's Request for Comments contemplate separate reviews of individual regulations, and AECC has identified 12 specific, long-standing regulatory practices that are demonstrably obsolete or in need of revision. Our detailed comments and suggestions for making these practices more effective and/or less burdensome are presented in Exhibit 1.

There are two "common threads" among these 12 regulatory practices, and these suggest more general ways in which the Board can improve the effectiveness of its approach to broad regulatory issues.

First, there are many circumstances where the Board has established a regulatory remedy to address a specific issue or concern, but the remedy has proved to be ineffective and has gone largely or completely unused. The identification of matters that require remedial actions or procedures represents an irreplaceable application of the Board's expertise. However, the value associated with the identification of problems is wasted if the adopted remedies are ineffective. This current regulatory review provides a clear mandate and opportunity for the Board to ensure that regulatory actions and procedures are made viable and effective for their intended purposes. In situations where the remedies for identified problems have not been viable and effective, the Board should not hesitate to exercise its ample corrective powers to adopt new, and effective, remedies.

Second, there are instances in which Board regulations largely nullify specific statutory remedies by superimposing requirements that have the effect of ensuring that the statutory remedies do not achieve their goal. Of course, the Board has made clear that it does not intend to make law, but rather to implement it, and the Board does not and cannot take regulatory actions outside the bounds established by the statutes. By the same standard of fidelity to the statutes, however, even if the Board believes that actions explicitly contemplated in the statutes would be ill-advised, its regulatory practices should not eviscerate or prevent altogether such actions unless and until it is directed to do so by Congress. This regulatory

**MCLEOD, WATKINSON & MILLER**

Docket No. EP 712  
January 10, 2012  
Page 3

review provides a clear mandate and opportunity for the Board to ensure that the regulatory practices developed over the past three decades are consistent with, and not burdensome to, the public interest as defined in existing Congressional direction.

AECC appreciates this opportunity to participate in the Board's review of its regulations, and hopes the Board finds these comments useful in its review process.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Eric Von Salzen', with a stylized, flowing script.

Eric Von Salzen  
Counsel for Arkansas Electric Cooperative Corporation

Michael A. Nelson  
101 Main Street  
Dalton, MA 01226  
Transportation Consultant

**EXHIBIT 1**  
**Arkansas Electric Cooperative Corporation's**  
**Comments and Suggestions**  
**Docket EP 712**

**1. Revenue Adequacy** - the Board's revenue adequacy criterion exceeds the statutory standard and is inaccurate and insufficient for its regulatory purpose.

**Empirical Evidence**

- Problems with cost-of-capital methodology (see item 2, below);
- The Christensen Study found that the Class I railroad industry was able to attract cost-minimizing quantities of capital no later than 1995;
- The Christensen Study found that the industry was revenue sufficient in 2006, and that the amount of differential pricing required to sustain adequate revenues declines with volume, but by the railroads' own claims "pricing power" has increased, and the Board has taken no remedial action;
- The BNSF acquisition premium for goodwill showed the railroad's ability to attract capital above the current value of all tangible assets, demonstrating satisfaction of the statutory criteria for revenue adequacy. Thus, the Board's finding of "revenue inadequacy" for BNSF was proved to be incorrect;
- Railroad evidence in EP 705 showed strong rail industry financial performance relative to other capital-intensive industries;
- The Cambridge Systematics Study demonstrated the rail industry's ability to supply needed expansion capital at current rates under realistic productivity assumptions;
- It has long been established that application of a nominal return to inflation-adjusted assets double-counts inflation in the allowed return;
- The Board's methodology inherently is susceptible to providing false indications of inadequacy due to its reliance on individual firm rather than regional or industry results. 1/

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1/ In any given year, an individual firm may experience fluctuations in its particular circumstances, including its competitive effectiveness, that cause its financial performance to vary relative to that of other firms. In the current duopolistic rail industry structure, it is completely possible that half of the firms would be found by the Board's methodology  
[continued next page]

### Recommendations

- Reduce the reliance on cost-of-capital computations;
- Add standards reflective of the statutory criteria;
- Add standards reflective of observed merger/acquisition premiums;
- Broaden the computations to reflect regional and/or industry conditions.

**2. Cost-of-Capital Determination** – the cost of capital methodology is inaccurate and insufficient for its regulatory purposes.

### Empirical Evidence

- The cost-of-capital determination under CAPM has followed the pattern previously forecast by AECC, 2/ in which increased earnings associated with increases in the exercise of rail market power have been misinterpreted by the model as increased risk, and translated (via an increased estimated beta coefficient) to a higher estimated cost of capital;
- In recent years, the Board's calculated cost of capital has been inflated by an increased value of beta, which is supposed to measure the amount of risk associated with investment in the industry relative to the overall market. However, the proposition that the rail industry has above-average risk is inconsistent with other data, including findings presented to the Board by AAR witness Myers in the cost-of-capital methodology proceeding, which showed a lengthy, stable period of below-average beta – and corresponding below-average level of risk – for railroads prior to the period of the increased exercise of market power. 3/ Since 2004, when railroads began to exercise increased market power, measured betas have increased

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to be revenue inadequate due solely to transitory traffic losses to the other major railroad in their markets, even though each region and the industry as a whole may be fully revenue adequate.

2/ See STB Ex Parte No. 664 (Sub-No. 1), Use of a Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital, "Comments of Arkansas Electric Cooperative Corporation" (April 14, 2008) at 2.

3/ See Ex Parte No. 664, Methodology To Be Employed In Determining The Railroad Industry's Cost Of Capital, Myers Reply Verified Statement (October 29, 2007), Figure 1.

## **AECC Comments and Suggestions, Docket EP 712 -- Continued**

substantially, and now show above-average risk. However, based on the methods used to compute beta, and the robust financial performance of the rail industry during the protracted recent recession, this appears to be an artificial increase in beta resulting from an increase in the exercise of rail market power, and not an increase in actual industry risk;

- Even without any correction for upward bias in recent beta measurements associated with the increased exercise of rail market power, CAPM now shows the entire rail industry to be revenue adequate; <sup>4/</sup>

- It is only the inclusion (in the MSDCF portion of the methodology) of analysts' stated expectations of increased earnings (which by definition incorporate any expectations held by analysts of an increased exercise of market power) that causes the overall estimated cost of capital to exceed current actual industry returns;

- The earnings growth projection implicit in MSDCF is excessively inconsistent with growth projections for the economy as a whole.

### **Recommendations**

- Restrict inconsistencies between earnings growth implicit in MSDCF vs. the economy as a whole;

- Modify MSDCF to control for assumed increases in the exercise of market power or reduce/eliminate the analyst-driven portion of the methodology;

- Apply CAPM with a beta consistent with stable historical measures not biased by increases in the exercise of market power.

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<sup>4/</sup> See STB Docket No. EP 558 (Sub-No. 14), Railroad Cost Of Capital—2010, decision served October 3, 2011. In the computation performed in Table 15, substituting the CAPM value of 0.1184 for the averaged value of 0.1299 yields a weighted average of  $((0.0461 \times 0.2338) + (0.1184 \times 0.7662)) = 0.1015$ .

## AECC Comments and Suggestions, Docket EP 712 -- Continued

**3. Bottleneck Rule** - The bottleneck rule is outmoded and produces impacts burdensome to shippers, carriers and the public interest.

### Empirical Evidence

- The Nelson Study on bottleneck issues 5/ documented the adverse impacts of the Bottleneck Rule on operating efficiency, investment incentives and the public interest, and was cited as an authoritative analysis in the joint USDA/US DOT Study; 6/
- Criteria established by the Board for obtaining bottleneck service have not enabled shippers to obtain bottleneck relief, notwithstanding the occurrence of inefficient single-line routes the criteria are supposed to prevent.

### Recommendations

- Revise/repeal the Bottleneck Rule, at least for trainload and unit train shipments.

**4. Competitive Access** - restrictions on the use of competitive access remedies are ill-defined, contrary to the public interest and unnecessarily burdensome to shippers.

### Empirical Evidence

- There has been essentially zero implementation of competitive access remedies of any type under any circumstances;
- The Board made no award of competitive access in Docket No. 42104 despite satisfaction of the stated criteria.

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5/ Nelson, Michael A., *Review and Analysis of Public Interest Considerations Associated with Rail "Bottleneck" Issues*. Prepared for Consumers United for Rail Equity (CURE) (March 12, 2008). With CURE's consent, much of the content of this analysis was incorporated in Appendix A of Mr. Nelson's statement in STB Ex Parte No. 680, Study of Competition in the Freight Railroad Industry, "Comments of Arkansas Electric Cooperative Corporation Regarding Study of Competition in the U.S. Freight Railroad Industry Conducted by Christensen Associates" (December 22, 2008).

6/ U.S. Department of Agriculture/U.S. Department of Transportation, Study of Rural Transportation Issues, (April 2010) at pages 187-8 and footnote 90. See <http://www.ams.usda.gov/AMSv1.0/ruraltransportationstudy>, Chapter 5.

## **AECC Comments and Suggestions, Docket EP 712 – Continued**

### **Recommendations**

The “competitive abuse” standard should be defined/interpreted as a carrier’s reliance on market power to deviate from a competitive norm.

**5. URCS** - the Board’s failure to implement substantive corrections/updates to URCS renders the Board’s enforcement of the requirement to use unadjusted URCS outmoded and ineffective..

### **Empirical Evidence**

- In rate cases the discrepancies between unadjusted and Board-approved adjusted costs are substantial;
- There has been a systematic failure of URCS to recognize and incorporate the substantial productivity improvements achieved in unit coal train operations;
- In the increasing number of major rate cases where rates are prescribed at the jurisdictional threshold, exaggeration of unit train variable costs by URCS creates supracompetitive returns for the carrier (i.e., by increasing the divergence between the jurisdictional threshold and the break-even rate from the SAC analysis).

### **Recommendations**

- Update URCS to ensure its accuracy for its regulatory purposes, or permit defined adjustments, particularly where a rate is established on the basis of the jurisdictional threshold.

**6. Railbanking** - The Board’s practice of preserving residual control of a railbanked line by the railroad that previously operated it is ineffective in the context of the purpose of railbanking and inappropriately burdensome to interstate commerce.

### **Empirical Evidence**

- Evidence presented to the Board in the DME construction case suggested that the former CNW “Cowboy Line” would be advantageous relative to the DME main line for the purpose of creating a new PRB access, but the Cowboy Line could not be used for a new PRB line by DME’s investors, coal users seeking to improve transportation options, or anyone else without approval by UP;



## **AECC Comments and Suggestions, Docket EP 712 – Continued**

- With all of the railbanking that has occurred, AECC is aware of no instances of a pro-competitive re-use of a railbanked line;
- The Board's own rules contemplate that a new user may use the railbanked ROW (Sect. 1152.29(c)(3)).

### **Recommendations**

- Remove any undue preference for the wishes of the prior operator when there is a bona fide proposal to reestablish rail service on a railbanked segment.

**7. Simplified SAC** - the limits on relief from Simplified SAC procedures render those procedures ineffective and are unnecessarily burdensome to shippers.

### **Empirical Evidence**

- The award limit in a Simplified SAC may be lower than a party's litigation cost;
- Essentially no one has used Simplified SAC.

### **Recommendations**

Remove or substantially increase the award limits.

**8. Market Dominance** - the market dominance criteria applied to establish a shipper's eligibility to pursue a rate complaint are ill-defined, outmoded, and unnecessarily burdensome to shippers.

### **Empirical Evidence**

- In major rate cases parties frequently stipulate that the SAC rate is under 180% R/VC, so the proposition that a rate above that threshold reflects effective competition is at best questionable;
- Recent rate complaints have posed complex issues of the competitive significance of unused alternatives, particularly in the context of technological change, that are far more likely to generate heat than light, even if substantial resources of the Board and the parties were devoted to them.

## **AECC Comments and Suggestions, Docket EP 712 -- Continued**

### **Recommendations**

- Establish a rebuttable presumption that rates over 180% R/VC evidence market dominance.

**9. Surplus ROW** - limits on use of a carrier's surplus right-of-way by another rail carrier are ill-defined and unnecessarily burdensome.

### **Empirical Evidence**

- No party has sought to utilize a carrier's surplus right-of-way pursuant to the Board's reference, in its Decision served February 12, 2007 in Finance Docket No. 34421, to the criteria associated with permissible crossings.

### **Recommendations**

- Clarify the applicable criteria and ensure that they do not enable an incumbent carrier to use its ownership of surplus real estate to obstruct bona fide rail use by another carrier.

**10. Merger Impacts** - the procedures/criteria applied by the Board to remedy competitive problems caused by past mergers are ineffective and unworkable.

### **Empirical Evidence**

- The Christensen Study found tangible harms from "3-to-2" mergers, but no party has come to the Board to remedy them;
- BNSF has not used its Central Corridor conditions from the UP/SP merger to compete for western bituminous coal traffic, as envisioned in the approval of the merger;
- By definition, shippers who do not have sufficient alternatives to prevent merger harm are susceptible to the merged carrier's exercise of market power, so the Board cannot reach a reliable conclusion regarding the absence of harm solely from the silence of such shippers;
- The Board virtually never uses its broad authority under Sections 722(c) or 11327 to remedy adverse merger impacts found after the fact.

### **Recommendations**

- Make meaningful relief for adverse merger impacts available under Sections 722(c) or 11327, including Board investigations on its own initiative.

**11. Service Emergencies** - the Board's Implementation of relief for service emergencies has been largely ineffective and unworkable.

### **Empirical Evidence**

- In Docket No. 42104, the Board specifically referenced emergency relief in a circumstance where it was not applicable (i.e., due to the duration of the emergency);
- When Entergy, co-owner with AECC of the White Bluff plant, applied for emergency relief at a time when such relief was applicable (i.e., during the 1997-1998 UP service "meltdown"), it was denied;
- The Board's reasoning in denying relief was entirely circular – the railroad was delivering poor service because it was experiencing protracted operational problems. The Board's deference to the incumbent railroad voided the entire purpose of the relevant statutes and regulations, and prevented realization of the emergency relief available from other carriers that would have minimized reliance on the troubled portion of the serving carrier's network.

### **Recommendations**

- Establish rules and precedents that ensure each carrier understands that it will be subject to meaningful intervention to ensure the provision of service by competitive carriers if it is unable to provide adequate service on its own.

**12. Timing** - regulations that govern the timing of complaints or petitions for relief in some instances are burdensome and undermine the achievement of regulatory objectives when they interfere, or prospectively interfere, with recognition and remedy of the underlying factors causing observed problems.

### **Empirical Evidence**

- In Docket No. 42104, the Board indicated (at footnote 17 on page 8 of its Decision served March 15, 2011) that the defendant railroads could have argued against relief in part on the basis of the timing of the request for relief. However, information only later disclosed by one of the defendants provided conclusive evidence of the role of its reliance on its market power as a

## **AECC Comments and Suggestions, Docket EP 712 -- Continued**

causal factor in the service problems at issue. The role of this market power in previous service problems was more evident in the context of a continuing pattern than it was at the time of the initial problems.

### **Recommendations**

- Establish rules and precedents that ensure (a) reasonable consideration is given to factors found to have caused tangible harms, even if such harms fall outside applicable limitations on direct relief; and, (b) new information is afforded no less weight than provided in Section 722(c) in instances where the new information would change the Board's view of a past circumstance.